

## Message Text

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TAGS: EGEN, CB

SUBJECT: ECONOMIC ASSESSMENT AT THE END OF THE WET SEASON

1. WITH THE CLOSE OF THE 1974 WET SEASON AND AS WE LOOK AHEAD TO THE UPCOMING DRY SEASON, IT IS CLEAR THAT THE ECONOMIC SITUATION CONTINUES TO BE GRIM. WHILE THERE HAS BEEN RELATIVELY LITTLE CHANGE IN THE MILITARY BALANCE DURING THE PAST WET SEASON, THE ECONOMIC SITUATION INCREASINGLY REFLECTS THE CUMULATIVE IMPACT OF THE WAR AND THE KHMER GOVERNMENT'S APPROACH TO ECONOMIC POLICY.

2. IN SOME SIGNIFICANT WAYS THE SITUATION IS BETTER THAN IT WAS EARLY IN 1974. IN FEBRUARY OF THIS YEAR, WHEN PHNOM PENH WAS SURROUNDED AND UNDER DIRECT ATTACK, THE KHMER REPUBLIC HAD ITS BACK AGAINST THE WALL. ITS CAPITAL CITY WAS BUT OFF, THE LAND IMMEDIATELY SURROUNDING THE CITY WAS ABANDONED BY FARMERS WHO HAD FLED, AND ABOVE ALL THE OVERLAND LINK TO THE ONLY SURPLUS REMAINING PROVINCES WAS CLOSED BY THE ENEMY. AS A RESULT, WITH THE SUPPLY OF TRADITIONAL COMMODITIES SUDDENLY COMPLETELY CUT OFF, PRICES SKYROCKETED. THE ANNUAL RATE OF INFLATION IN MARCH WAS PROBABLY IN THE RANGE OF 320 PERCENT PER YEAR.

3. MANY MEASURES, MILITARY AND ECONOMIC, WERE TAKEN BOTH BY US AND BY THE KHMER. THE PERIMETER AROUND PHNOM PENH WAS EXPANDED AND THE LAND LINK WITH THE WESTERN PROVINCES OPENED VIA THE TONLE SAP RIVER AND ROUTE 5. NEW TRANSPORTATION ASSETS WERE PROVIDED UNDER THE AID PROGRAM TO MOVE CRITICAL

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DOMESTIC COMMODITIES INTO PHNOM PENH. A QUICK IMPACT

PRODUCTION PROGRAM WAS INITIATED TO TRY AND INCREASE THE SUPPLY OF CERTAIN COMMODITIES, PARTICULARLY FISH AND MEAT. THESE EFFORTS HAVE HAD SOME SUCCES , AND THE RATE OF INFLATION INSTEAND OF FURTHER ACCELERATING HAS SLACKED OFF A BIT. WE ESTIMATE THAT THE PRESENT RATE OF INFLATION, ON AN ANNUALIZED BASIS, IS ABOUT 80 PERCENT.

4. NEVERTHELESS THE UNDERLYING ECONOMIC SITUATION IS MOST PRECAIRIOUS. HYPERINFLATION, ONCE BEGUN, IS HARD TO STOP AND THE PRICE INCREASES THAT HAVE OCCURED ARE INEVITABLY A PERMANENT PART OF THE KHMER SCENE. CONSEQUENTLY ADJUSTMENTS IN GOVERNMENT CONTROLLED PRICES, SUCH AS FOR PL 480 RICE, FOR FOREIGN EXCHANGE, AND FOR IMPORTED PETROLEUM PRODUCTS ALL NEEDED TO BE MADE TO CORRET THE IMBALANCE WHICH THE HYPERINFLATION HAD BROUGHT ABOUT. THIS WAS DONE IN SEPTEMBER WHEN THE FOREIGN EXCHANGE RATE, PL 480 RICE AND PETROLEUM PRICES WERE ALL TRIPLED. IT WAS HOPED THAT THESE MEASURE WOULD REDUCE MONETARY EXPANSION, MODERATE THE INCREASES IN OTHER PRICES, HELP INCREASE AGRICULTURAL PRODUCTION, AND REDUCE THE PRESSURES OF THE EXCHANGE MARKET. THESE MEASURES, WHILE SEVER, WERE ABSOLUTELY ESSENTIAL FOR THE SURVIVAL OF THE KHMER REPUBLIC'S ECONOMY. BUT THEY WILL NOT, BY THEMSEVLES, BRING ABOUT IMPROVEMENT IN THE ECONOMIC SITUATION.

5. THIS IS BECAUSE OF TWO SETS OF CONDITIONS:

A) THE GOVERNMENT'S LOSS OF TERRIOTY, THE SHIFT OF 25 PERCENT OF THE POPULATION UNDER GOVERNMENT CONTROL FROM BEING PRODUCERS TO BEING REFUGEES, ABANDONMENT OF HUNDREDS OF THOUSANDS OF ACRES OF RICELAND, THE CLOSING OF MAJOR ARTIERIES OF SUPPLY HAS AN EVER DEEPENDING ECONOMIC EFFECT.

B) IN THE LAST FEW YEARS THE GOVERNMENT HAS INCREASED ITS BUDGETARY EXPENDITURES IN AN ATTEMPT TO FINANCE THE WAR AND MEET ITS ENLARGING CIVIL AND MILITARY PAYROLL . HOWEVER, SINCE IT IS DOING THIS IN THE FACE OF RAPIDLY SHRINKING RESOURCE AS TERRIOTY WAS LOST, THE RESULT HAS BEEN MORE MONEY CHASHING FEWER GOODS. NOT ONLY DID THIS LEAD TO THE PRESENT HYPER-INFLATION BUT PERHAPS MORE IMPORTANTLY, THE GOVERNMENT'S PRACTICES HAVE ALSO LED TO A FURTHER DECLINE IN THE LEVEL OF PRODUCTION. THIS HAS BEEN IN NO SMALL DEGRE A RESULT OF FOLLOWING POLICIES OF MAINTAINING LOW FIXED EXCHANGE RATES,

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LOW CONSUMER PRICES FOR RICE AND OTHER PRODUCTS WHILE AT THE SAME TIME EXPANDING THE BUDGET IN A PERIOD OF RAPIDLY RISING PRICES.

6. REVIEWING THE ECONOMIC SITUATION AT THIS TIME IT IS CLEAR THAT THE DIFFICULTIES FACING US AND THE KHMER GOVERNMENT ARE ENORMOUS. WHILE AT THE MOMENT TH ECONOMIC SCENE IS RELATIVELY TRANQUIL, CERTAINLY MORE SO THAT EARLY THIS YEAR,

IT IS EXCEPTIONALLY DIFFICULT TO COME TO ACCURATE JUDGEMENT AS TO WHAT THE STATE OF THE ECONOMY WILL BE DURING THE NEXT SIX MONTHS.

7. ONE ASPECT WHICH MAKES FORECASTING ESPECIALLY HAZARDOUS IS THAT THE ECONOMIC VIABILITY OF THE KHMER REPUBLIC IN 1975 DEPENDS, MUCH MORE SO THAN IN PREVIOUS YEARS, ON THE SUPPORT OF FOREIGN AID AND ALSO ON THE DEGREE OF DISCIPLINE WHICH THE GOVERNMENT INTRODUCES INTO THE MANAGEMENT OF ITS BUDGET.

8. WE ARE CONFIDENT THAT WE CAN CONTINUE TO KEEP PHNOM PENH AND OTHER FOOD-DEFICIT AREAS SUPPLIED WITH RICE EVEN THOUGH THE AMOUNT REQUIRED UNDER PL 480 (325,000 TONS NEXT YEAR) IS SUBSTANTIAL. WE ALSO BELIEVE THAT SOME PROGRESS CAN BE ACHIEVED IN OUR JOINT EFFORTS TO AUGMENT SOMEWHAT THE SUPPLY OF DOMESTIC COMMODITIES IN PHNOM PENH ALTHOUGH THIS DEPENDS OVERWHELMINGLY ON STABILITY OF THE MILITARY SITUATION. WE ARE LESS CERTAIN AS TO WHETHER THE REQUISITE DISCIPLINE CAN BE BROUGHT TO BEAR ON BOTH MILITARY AND CIVIL AUTHORITIES TO CONTAIN THE EXCESSES INHERENT IN THE PRESENT FINANCIAL AFFAIRS OF THE GOVERNMENT. IF THIS LATTER PROBLEM CAN BE BROUGHT UNDER CONTROL, AND IF, OF COURSE, THE MILITARY SITUATION REMAINS RELATIVELY STABLE, THE KHMER ECONOMY CAN SURVIVE YET ANOTHER SIX MONTHS. HOWEVER, WITHOUT SIGNIFICANT PROGRESS IN SOLVING THIS PROBLEM, THE GREAT AND ULTIMATE CRISIS OF THE KHMER ECONOMY IS APT TO COME UPON US DURING 1975, AND PROBABLY EARLIER IN THE YEAR RATHER THAN LATER.

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